United States Court of Appeals

for the Second Circuit

REPLY BRIEF

No. 76-6040

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA and WALTER ROSS, Revenue Agent, Internal Revenue Service,
Petitioners-Appellants, Cross-Appellees,

v.

GEOFFREY DAVEY, As Secretary of THE CONTINENTAL CORPORATION,
Respondent-Appellee, Cross-Appellant.

On Appeal From the United States District Court for the Southern District of New York

BRIEF OF RESPONDENT-APPELLEE AND CROSS-APPELLANT

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ISSUES RAISED BY CROSS-APPEAL

Whether the District Court erred in holding that the summons provisions of 26 U.S.C. § 7602 authorize the Internal Revenue Service to compel the production of computer tapes which only contain information already made available to the I.R.S. in the books and records used to prepare the taxpayer's Federal income tax returns.

ISSUES RAISED BY THE GOVERNMENT'S APPEAL

1. Whether the District Court, in a situation where the Internal Revenue Service seeks to remove computer tapes from their protective storage facilities for an indefinite length of time during which unspecified individuals will handle and operate the tapes, may protect against loss or damage to the tapes by directing the taxpayer to provide duplicates prepared under the supervision of an I.R.S. computer specialist.

2. Whether the District Court, after weighing the burden imposed on the taxpayer solely for the convenience of the I.R.S., may condition enforcement on the I.R.S. reimbursing the taxpayer for the reasonable and necessary expenses of producing duplicate tapes to be turned over to the I.R.S.

APPELLEE-CROSS-APPELLANT'S STATEMENT OF THE CASE

(a) Proceedings Below.

Geoffrey Davey, as Secretary of The Continental Corporation, respondent-appellee, cross-appellant ("Continental Corporation" or the "Company"), appeals from the judgment of the United States District Court for the Southern District of New York by the Honorable Henry F. Werker, entered December 18, 1975, insofar as it requires Continental Corporation to duplicate specified computer tapes and to turn the duplicates over to I.R.S. (A-163).[1] Continental Corporation, as appellee, supports the portion of the District Court's judgment holding that, if the tapes must be produced, Continental Corporation's interest in protecting the tapes is to be safeguarded by having the tapes duplicated under the supervision of an I.R.S. computer specialist, with these duplicates to be provided to the I.R.S. upon

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[1] Reference to the Record will be to the Joint Appendix on Appeal which is cited as (A-).

reimbursement of the reasonable and necessary expenses of duplication.

The District Court's judgment was entered pursuant to its memorandum decision of December 4, 1975, following a hearing on October 16, 1975. *United States* v. *Davey*, 404 F. Supp. 1283 (S.D.N.Y. 1975). (A-157-62).[1] Continental Corporation filed a timely notice of cross-appeal on February 20, 1976, following the Government's notice of appeal on February 13, 1976. Jurisdiction is conferred on this Court by 28 U.S.C. § 1291.

(b) Statement of Facts.

Continental Corporation has for many years been subjected to the "large case" audit program of the I.R.S., with the result that a team of I.R.S. agents has been almost constantly on the Company's premises since the middle 1960's (A-11, A-53, A-68-69). Continental has provided an office at its headquarters for the exclusive use of these agents. (A-53-54, A-69).

The Service has requested massive amounts of information from the Company, frequently involving transactions occurring many years ago. Continental has fully complied with these requests by annually expending substantial time, money and effort, including a costly expansion and reorganization of its tax department. (A-53-54). At present, one member of the tax department devotes substantially his entire working time to fulfilling the agents' many information requests, while other staff members devote significant amounts of their time to working with the I.R.S. agents. (A-54, A-69). Continental has never sought—and is not now seeking—reimbursement of these costs in any form.

The present dispute arises from an I.R.S. summons (A-18-19) seeking computer tapes for the years 1971 and 1972, which the Company used as a processing tool to convert certain general expense and loss information contained in

original invoices and vouchers into hard-copy print-outs constituting Continental's permanent records. (A-54-55). All information on the tapes appears in these permanent records. (A-54, A-88). The permanent records for the years 1971 and 1972 have been made fully available to the I.R.S. (A-70).

To justify the summons of these tapes, the Government initially contended that without the tapes individual transactions could not be traced from the original documents (vouchers, invoices, etc.) to the tax return, or vice versa. (A-101). This contention is simply untrue, as the Government's witnesses finally admitted at the hearing. (A-124-25). The I.R.S. has for years satisfactorily audited Continental by examining the permanent printed records. Even though similar computer tapes were available in past years, the revenue agents never before requested them. (A-124-25). The Government witnesses conceded at the hearing that the *printed* records of the Company permit the complete tracing of an item from the original documents to the tax return. (A-124-25).

The I.R.S. further claimed that these tapes were necessary because the print-outs from the summoned tapes do not contain brokerage, commission, and payroll expenses. (A-33). However, the summoned tapes themselves do not contain brokerage, commission or payroll expenses; this information is contained only in Continental's printed records, which have always been available for I.R.S. inspection. (A-47).

Continental Corporation does *not* have a computerized accounting system. Even with all of Continental's tapes, the I.R.S. could not trace a transaction from original documents to the return. That can only be done from the hard-copy permanent books and records. (A-55). The computer tapes are used solely to process expense and loss information pertaining to the twelve Continental Insurance Com-

panies in the format required by applicable regulations of the State insurance commissions.

For accounting purposes, the Continental Insurance Companies are divided into eight geographic departments. General expense and loss information for each department is punched onto computer cards from data contained on the original source documents, such as vouchers and invoices. This departmental information is aggregated at the Neptune, New Jersey computer facility of the INSCO Systems Corporation [2] to produce nationwide general expense and loss tapes. (A-44, A-86).

The Continental Insurance Companies are subject to the detailed accounting and reporting requirements of the National Association of Insurance Commissioners ("N.A.I.C."). The function of the tapes is to produce monthly and summary print-outs in the format required by the N.A.I.C. regulations. (A-54-55). The monthly print-outs contain a detailed register of all general expenses and losses of the Continental Insurance Companies, along with a voucher or other identifying number of the associated original documents. These original documents, in turn, identify the payee and check number for each payment. (A-45). Summaries, known as Regulation 30 statements, of the general expenses and losses are printed-out and prepared during the year, again in the format required by the N.A.I.C. regulations. (A-45-46). The year-end Regulation 30 summary is used to prepare the Annual Statement and Insurance Expense Exhibit in accordance with N.A.I.C. requirements. (A-46). Under section 832 of the Internal Revenue Code, the taxable income of the Continental Insurance Companies is based on this Annual Statement.

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2 INSCO is an affiliated company that provides data processing services for Continental Corporation, as well as a number of unrelated parties. (A-85).

At the hearing, the I.R.S. agents ultimately conceded that they want the tapes in order to "pull out" expenses in excess of specified amounts. (A-119, A-135). The tapes are not necessary for this purpose. At most, they would perhaps speed up the agents' work. Without the tapes the agents could "skim" the pages of Continental's permanent books for large items, a process which the District Court estimated would take about "two seconds" per page. (A-83-84).[3]

The Government appears to argue that INSCO can be compelled to allow I.R.S. agents to use INSCO computers to re-program the tapes. (Gov't Brief, p. 11).[4] However, because its computers are extremely sophisticated and valuable, INSCO has an established general policy of not allowing *any* outsider to operate its equipment. (A-91-92). The cost to INSCO of allowing the I.R.S. to use its computers would be $750 per hour, based on INSCO's normal charges to third parties. (A-47). The I.R.S. has never indicated, even generally, how much computer time would be consumed if the I.R.S. were allowed to use INSCO's computers. (A-47).

If the Service uses its own computers, the Company's tapes would have to be removed from the specially designed protective storage facilities in which they are now kept. (A-90). In that event, Continental would be required to make duplicates to guard against risk of damage. (A-55). Computer tapes can be damaged in a number of ways, *e.g.*, by exposure to heat, magnetism, or electricity. Furthermore, tapes can be accidentally erased by even an experienced operator. (A-46). At no point during the proceed-

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[3] Even at five seconds per page, and assuming 7,000 pages, the total time required to scan the items would be less than ten hours. Since the I.R.S. has agents on the Continental premises for 365 days per year, this ten hours would not appear to be burdensome.

[4] The April 15, 1976 brief on appeal by appellants-cross appellees is cited (Gov't Brief, p. —).

ings below did the Government offer any evidence as to the procedures the I.R.S. would use to protect the tapes. Duplication of the tapes requires the purchase of new reels and the use of personnel and computer time. (A-46-47, A-91).

SUMMARY OF ARGUMENT

Continental does not seek to deny the I.R.S. access to any information or data pertinent to its tax return or tax liabilities. *All* information on the summoned computer tapes appears on print-outs. These print-outs and Continental's other permanent records readily allow the agents to trace individual transactions from the original documents to the tax returns, and back again. Continental cannot be compelled under section 7602 to produce tapes merely to serve the convenience of the agents by saving them five or ten hours of work. Section 7602 permits the I.R.S. to summon "books and records," but not intermediate processing tools. Finally, the I.R.S. has not discharged its burden of proving that the information sought is not already available to it.

Alternatively, if the tapes must be produced, the District Court properly authorized the production of duplicate tapes upon the I.R.S.'s reimbursement of Continental's reasonable and necessary duplication expenses. Contrary to the Government's assertions, the District Court has broad discretion to modify the summons before ordering enforcement. The District Court here did not abuse its discretion. It merely required the I.R.S. to comply with its own guidelines and normal administrative practices, which require the I.R.S. to pay for duplicates, at its own expense, whenever it seeks to remove materials from their normal place of storage.

ARGUMENT I

THE DISTRICT COURT ERRED IN HOLDING THAT 26 U.S.C. § 7602 CAN BE USED TO COMPEL THE PRODUCTION OF COMPUTER TAPES WHEN ALL THE INFORMATION ON THE TAPES HAS ALREADY BEEN MADE AVAILABLE IN THE TAXPAYER'S BOOKS AND RECORDS

The present case involves a novel and unwarranted attempt to expand the I.R.S. summons power. Continental has never denied that the I.R.S. is entitled to obtain whatever information is needed to determine the correctness of its tax liability. Continental does, however, object to the theory that the summons power can be used by I.R.S. agents to obtain intermediate processing tools (computer tapes) solely for the convenience of the I.R.S., where the data is fully available otherwise in printed form.

Point I

The Requirement of Section 7602 that the Information Sought Must Be "Relevant and Material" to an Examination of the Taxpayer's Return Is Not Satisfied by a Showing of Marginal Convenience to the Agents.

The I.R.S. summons power is broad, but not unlimited. The power is designed solely to meet the audit needs of the I.R.S., and cannot be exercised in a way which will impose unnecessary burdens on the taxpayer. *See, e.g.*, Section 7605(a) (the time and place of examination must be "reasonable"); Section 7605(b) ("No taxpayer shall be subjected to unnecessary examination or investigations"). *See also U.S. Aluminum Siding Corp.* v. *Eshleman*, 170 F. Supp. 12, 14 (N.D. Ill. 1958) (I.R.S. does not have "untrammeled discretion" in issuing summons).

The taxpayer cannot be compelled to turn over secondary materials merely because the convenience of the agents would be served. *United States* v. *Matras*, 487 F.2d 1271, 1275 (8th Cir. 1973) (for purposes of the I.R.S. summons power, the "term 'relevant' connotes and encompasses

more than 'convenience' ".) Section 7602 cannot be used to force the taxpayer to provide the I.R.S. agents with adding machines, scratch paper, dining facilities, or any of the hundreds of other things which might make their auditing tasks easier. The I.R.S. itself recognizes that a "witness [summoned under Section 7602] cannot be required to prepare or create documents not currently in existence."[5] Internal Revenue Manual § 4022.64(4). This, however, is precisely what the I.R.S. is attempting to compel here. The Government appears to claim that Continental can be directed to turn its computer facilities over to the I.R.S. so that Continental's books can be re-arranged in a format more to the agents' liking, even though Continental's books now comply with the requirements of state insurance laws and the Internal Revenue Code. (A-156, Gov't Brief, p. 11). This assertion of I.R.S. power seems clearly to exceed the scope of the summons power authorized by Congress.

Alternatively, the I.R.S. claims that it can remove Continental's tapes from their specially designed protective storage facilities and take them to its own computer centers for an unspecified period of time. However, the I.R.S. can remove materials from where they are normally kept only upon a showing of need. *See United States* v. *United Distillers Products Corp.*, 156 F.2d 872 (2d Cir. 1946); I.R.S. Technical Information Release 985 (1968); *cf. United States* v. *Ruggeiro*, 425 F.2d 1069 (9th Cir. 1970), *cert. denied sub nom. Kyriaco* v. *United States*, 401 U.S. 922 (District Court did not abuse its discretion in ordering enforcement of summons where I.R.S. agreed to inspect records at their place of storage.) *See also, F.T.C.* v. *Texaco,*

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[5] The concept of "relevancy" does not extend to compelling a party to summarize or re-arrange information already made available. *Leonia Amusement Corp.* v. *Loew's, Inc.*, 18 F.R.D. 503, 507 (S.D.N.Y. 1955); *United Cigar-Whalen Stores Corp.* v. *Phillip Morris, Inc.*, 21 F.R.D. 107, 109 (S.D.N.Y. 1957); *United States* v. *Renault, Inc.*, 27 F.R.D. 23, 27-28 (S.D.N.Y. 1960).

Inc., 517 F.2d 137, 151 (D.C. Cir. 1975) (District Court properly required F.T.C. to inspect subpoenaed documents where they were stored.) As this Court has noted in an administrative subpoena enforcement proceeding in *Walling* v. *American Rolbal Corp.*, 135 F.2d 1003 (2d Cir. 1943):

> "Requiring records to be produced away from the place where they are ordinarily kept may impose an unreasonable and unnecessary hardship which in itself would make the issuance of the subpoena, otherwise proper, arbitrary and capricious." 135 F.2d at 1005.

The requisite showing of need has not been made in the present case. The tapes are sought only to serve the marginal convenience of the agents.

This is not a case where the information underlying the tax return is found only on computer tapes. Nor is it a case where the taxpayer's entire accounting system is computerized, so that a verification of transactions by tracing from the original documents to the return, and back again, would be difficult or impossible without the use of computers. Here the I.R.S. thoroughly audited Continental for many years during which Continental had simliar tapes, and the I.R.S. saw no reason even to request the tapes. (A-124-25).

The agents want the tapes simply to pull out expenditures above a certain amount. The tapes may be convenient for this purpose, but they are certainly not necessary. (A-83-84). The agents may desire to complete their audit without being required to examine the taxpayer's permanent records, but this desire is not a basis for invoking the compulsory processes of section 7602.

Point 2

Continental's Permanent Records—and Not the Tapes—Are the "Books and Records" that May Be "Examined" Under Section 7602

Section 7602 does not authorize the Service to summon anything it wishes to examine. The statute is very precise—the Service may summon only "books, records, papers, and other data." 26 U.S.C. § 7602. This phrase refers to visible and legible books and records—not to intermediate processing tools such as computer tapes. In previous summons cases, the I.R.S. has significantly requested print-outs, not the tapes. *United States* v. *Davey*, 426 F.2d 842 (2d Cir. 1970).[6] This simply reflects the fact that the print-outs, not the tapes, are the "books and records." *United States* v. *Russo*, 480 F.2d 1228 (6th Cir. 1973), *cert. denied*, 414 U.S. 1157 (1974); *United States* v. *DeGeorgia*, 420 F.2d 889 (9th Cir. 1969); *Merrick* v. *United States Rubber Co.*, 440 P.2d 314 (Ariz. 1968). *Cf.* Rule 1001(3), Federal Rules of Evidence, 28 U.S.C.A. In Revenue Procedure 64-12, 1964-1 Cum. Bull. (Part I) 672, the I.R.S. recognized that for audit purposes the taxpayer need only print out and provide "visible and legible records" which "coincide with financial reports for tax reporting periods" and which permit tax return figures to be traced to original documents. Continental has already made available to the I.R.S. records which comply with these standards.

The only case cited by the Government in which tapes were required to be produced is *Adams* v. *Dan River Mills, Inc.*, 54 F.R.D. 220 (W.D. Va. 1972), a decision under Rule 34 of the Federal Rules of Civil Procedure. As the Government points out in its brief, the instant case is not a

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[6] Furthermore, when taxpayers have attempted to obtain computer-stored information from the Government, the Government has successfully argued that only print-outs need be produced. *United States* v. *Farris*, 517 F.2d 226 (7th Cir. 1975), *cert. denied*, — U.S. —; *United States* v. *Liebert*, 519 F.2d 542 (3d Cir. 1975), *cert. denied*, — U.S. —.

Rule 34 case. In reality, the *Adams* case supports Continental's position. In the *Adams* decision, computer tapes were held to be discoverable because Rule 34 was expanded by a 1970 amendment to include computer materials. Even before the 1970 amendment, Rule 34 was broader than section 7602 since it allowed discovery of "documents, papers, books, accounts, letters, photographs, objects, or tangible things . . . ." If this broad language had to be amended to include computer tapes, it seems clear that the narrower language of section 7602 does not cover tapes. *Keifer & Keifer* v. *Reconstruction Finance Corp.*, 306 U.S. 381 (1939); *Federal Housing Administration* v. *Burr*, 309 U.S. 242 (1940). Whether section 7602 should be expanded to include computer tapes is a decision for Congress.[7]

Section 7602 authorizes the I.R.S. only to "examine" books and records. The basic meaning of "examine" is "to inspect closely." Webster's Seventh New Collegiate Dictionary (G. & C. Merriam Co., 1965). In this case, the summons of the I.R.S. is not directed to an "examination" or inspection of the tapes, but rather to a reprogramming and reprocessing of the tapes. There is nothing in section 7602, however, which authorizes the I.R.S. to secure computer tapes in order to produce revised print-outs in place of the original print-out records of the taxpayer.

Point 3

The Requirements of Section 7602 Have Not Been Met Where the Information on the Tapes Has Already Been Made Available to the Agents

An I.R.S. summons will not be enforced unless the Government discharges its burden of proving that the information sought has not already been made available to the agents. *United States* v. *Powell*, 379 U.S. 48, 57-58 (1964);

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[7] Whenever phrases such as "books and records" are intended to include computer tapes, specific language to that effect has been used. *See* Rule 803(6), Federal Rules of Evidence, 28 U.S.C.A.

United States v. *McCarthy*, 514 F.2d 368 (3d Cir. 1975); *United States* v. *Theodore*, 479 F.2d 749 (4th Cir. 1973); *United States* v. *Pritchard*, 438 F.2d 969 (5th Cir. 1971); *Reineman* v. *United States*, 301 F.2d 267 (7th Cir. 1962). This requirement recognizes that the I.R.S. summons power cannot exceed that necessary for the Service's auditing function. *Cf.* 26 U.S.C. § 7605(a) and (b); *United States* v. *Lubus*, 370 F. Supp. 695 (D. Conn. 1974) (summons not enforced where I.R.S. has alternative method of obtaining the desired information).

Since all the information that could be found on the tapes has already been made available, the Government has not met its burden of proof in this summons enforcement proceeding. The order to the taxpayer to duplicate its tapes and turn the duplicates over to the I.R.S. should be reversed.

ARGUMENT II

THE DISTRICT COURT CORRECTLY HELD THAT IF THE TAPES ARE TO BE PRODUCED, THE TAXPAYER IS ENTITLED TO A PROTECTIVE ORDER AUTHORIZING THE PRODUCTION OF DUPLICATE TAPES PREPARED UNDER THE SUPERVISION OF AN I.R.S. COMPUTER SPECIALIST, UPON REIMBURSEMENT OF THE REASONABLE COSTS OF DUPLICATION

The District Court heard extensive testimony which established that Continental's computer tapes are being sought solely to serve the convenience of the I.R.S., and that duplicates would be required to protect against the risks of loss or damage. On the basis of that evidence, the District Court fashioned an order to protect the reasonable interests of both parties. The Government seeks to overturn that order, insofar as it takes into account the interests of Continental, on the basis of an almost unprecedented challenge to the power of the courts to fashion appropriate remedies.

Point I

The District Court Properly Authorized the Production of Duplicate, Rather than Original, Tapes

The Government claims that the District Court may only enforce an I.R.S. summons precisely as written. (Gov't Brief, pp. 6-8). Thus, the Government claims that the District Court abused its discretion when it ordered Continental to produce duplicate tapes "under the supervision of a Computer Specialist or other representative who may be assigned by the Internal Revenue Service . . . " (A-163). The Government has never claimed that it will be harmed in any way by this procedure. The duplicate tapes will contain exactly the same materials as the originals. In fact, the Government itself initially suggested the procedure by which duplicates would be turned over to the I.R.S. (A-35-36).

The Government's position on appeal is also directly contrary to the I.R.S.'s own guidelines for the implementation of the computer audit program. Mr. Martin B. Roberts, an I.R.S. consultant on the computer audit program, has explained that:

> "Where the [computer] records must be taken off the premises, the guidelines recommend that the I.R.S. be provided with duplicate tapes instead of the original records." Roberts, "IRS Guidelines for Retention of Data Processing Records," 132 *Journal of Accountancy* 77, 80 (July 1971).

The Government is thus arguing that the District Court must be reversed because it adopted a procedure for compliance recommended by the I.R.S. itself.

A. District Courts Have Broad Discretion To Modify I.R.S. Summonses.

The Government's contention that the District Court lacked the power to modify the summons based on a weighing of the interests of the parties has been consistently rejected by the courts. *See, e.g., United States*

v. *Luther*, 481 F.2d 429, 433 (9th Cir. 1973); *United States* v. *Dauphin Deposit Trust Co.*, 385 F.2d 129 (3d Cir. 1967), *cert. denied*, 390 U.S. 921 (1968); *Dunn* v. *Ross*, 356 F.2d 664 (5th Cir. 1966). The Government's contention is directly contrary to the accepted rule that in proceedings to enforce administrative subpoenas, the courts may impose conditions and restrictions which they deem appropriate, even where the materials sought are relevant to a proper inquiry. *Goldberg* v. *Truck Drivers Local Union No. 299*, 293 F.2d 807, 814 (6th Cir. 1961), *cert. denied*, 368 U.S. 938 (1961); *Civil Aeronautics Board* v. *Hermann*, 353 U.S. 322 (1957); *Walling* v. *American Rolbal Corp.*, 135 F.2d 1003, 1005 (2d Cir. 1943).

This Court has consistently upheld the broad discretion of the district courts to modify I.R.S. summonses before ordering enforcement. In *United States* v. *United Distillers Products Corp.*, 64 F. Supp. 978 (D. Conn. 1946), the Government sought enforcement of a summons for a taxpayer's books and records. The court modified the summons so as to minimize the burdens on the taxpayer, and stated:

> "When the Court is called upon to use its equitable powers, however, it would seem that reasonable conditions may be imposed upon their exercise to avoid unnecessary hardship while carrying out the purpose of the statute, the protection of the revenue. . . .
>
> * * *
>
> "The enforcement of the summons will be required by the Court with such conditions as are listed in the Order of Court already issued, . . . to avoid unnecessary interruption of the taxpayer's business and trucking of unnecessary files." 64 F. Supp. at 979.

The modification of the summons was upheld in *United States* v. *United Distillers Products Corp.*, 156 F.2d 872 (2d Cir. 1946):

> "The case involves essentially a practical problem of administration in the light of facts and personalities

> necessarily more clearly disclosed to the court which heard the evidence than to us. Moreover, that court is close at hand to hear and properly to evaluate a renewed application, should one be made, which may show a better climate of opinion between the parties and easier methods of achieving the statutory purpose with less burden to the taxpayer. In matters so largely of administrative detail, our function should only be to correct abuses of discretion and of power by the trial judge." 156 F.2d at 875.

In *In Re Magnus, Mabee & Reynard, Inc.*, 311 F.2d 12 (2d Cir. 1962), *cert. denied*, 373 U.S. 902 (1963), this Court again described the proper role of the district courts in I.R.S. summons enforcement proceedings:

> "A considerable degree of discretion should be vested in the district courts to work out the appropriate limitations on which records are subject to investigation and the best location of such an inspection for all concerned. It may well be that the examinations can be conducted at the offices of the corporation and the accountants. If the parties are unable to agree, the district judge is empowered to find that solution leading to the most efficient examination of such records consonant with the least possible interference with the everyday conduct of the corporation's business." 311 F.2d at 17.

B. The District Court Had Ample Evidence To Justify Authorizing Production of Duplicate Tapes.

The Government also contends that the District Court had no evidence upon which to find that the tapes would be subject to risks of accidental loss or damage if removed from their present storage facilities and shipped to an I.R.S. computer facility for an indefinite period of time. This contention is without merit.

As the Government concedes in its brief (Gov't Brief, p. 10), the only testimony on this point was that of Mr. George Moore, who has more than 25 years experi-

ence in the data processing field. (A-44). Mr. Moore testified unequivocally that computer tapes may be damaged if exposed to heat, magnetism, or an electrical field. (A-46, A-90). Consequently, the tapes are stored in specially designed, climate-controlled and fire preventive facilities. (A-90). Furthermore, Mr. Moore in his affidavit notes that tapes have been accidentally erased by even experienced operators. (A-46).

In an effort to rebut this clear testimony, the Government points to the statement by Agent Rosenberg, the I.R.S. computer specialist, that he had never previously been denied *access* to computer tapes. (Gov't Brief, p. 11, A-128). How this bears on the risk of loss or damage is never explained in the Government's brief. The Government further states that the District Court abused its discretion in finding there would be a risk of loss or damage by pointing to what it views as substantial evidence of the "training and experience of the I.R.S. agents who would be using the summoned tape." (Gov't Brief, p. 11). The evidence of "training and experience" pointed to by the Government consists of a statement by Revenue Agent Ross, as follows:

> "Q. Why did you decide to ask for tapes of the Continental Corporation?
>
> A. Because the 1971 year and subsequent years were programmed to include a computer audit specialist which was not done previously because of Revenue Ruling 7120 [*sic.*]. We did not have a need for that prior to that and the Government implemented a special group called Computer audit Specialists." (A-123).

This is the sum total of the evidence allegedly offered by the Government on the training of the I.R.S. computer specialists.

The Government further attempts to discredit the District Court's findings on this point by referring to the

cross-examination of Mr. Moore, the INSCO official who testified as to the possibilities of damage. Government counsel made much of certain quotes from an unidentified article in the June 1974 issue of the *Journal of Accountancy*. Government counsel was referring to "Physical Security in EDP—An Overview," 137 *Journal of Accountancy* 46 (1974), which is an interpretation by one of the Journal's editors of a speech by a computer specialist. This article, which details the numerous precautions that must be taken to protect tapes, states that tapes can be damaged at temperatures of 150° and thus "must be stored in a fire-resistant cabinet or vault if they are to be preserved or protected." *Id.* at 48. The article goes on to explain that tapes are subject to damage from exposure to magnetic fields and must be shipped with three inches of packing on all sides. *Id.* The Government did not offer evidence that this necessary precaution would be taken, and in fact the Computer Audit Handbook of the I.R.S. indicates that the I.R.S. routinely sends tapes through regular mail with only a notation on the package that magnetic tapes are enclosed. Internal Revenue Manual ¶ 42(13) 1.6(8)(b). The Government also suggested that the risk of accidental erasure might be lessened if the operator remembers to use certain special devices during the course of operation (A-107-08), but failed to introduce any evidence on what procedures, if any, would be used by the I.R.S. to protect Continental's tapes from accidental loss or damage.

The Government contends that Continental has no concern for the safety of the tapes because it allegedly transports its tapes through "regular mail." (Gov't Brief, p. 9). We assume that the Government is thus conceding that the I.R.S.'s practice of sending tapes through the regular mails indicates a careless disregard for the risks of loss or damage. In any event, the allegation that Continental sends its tapes through the regular mails is false.

The Government cites Mr. Moore's cross-examination during which Government counsel asked if Continental sends its tapes by mail. Mr. Moore replied that they are sent *by air freight*. (A-110). We would have assumed that the Government was aware of the difference between regular mail and air freight—especially in terms of handling and risk of loss.

The Government attempts to argue that the District Court should not have taken into consideration the risks of loss or damage because approximately five years ago Continental had a general policy of retaining tapes for only thirty days. (Gov't Brief, p. 9). That policy was established, however, before the I.R.S. asserted that computer tapes must be retained by taxpayers. In light of its position on retention of tapes, the I.R.S. is hardly in a position to assert that protection of the tapes is unnecessary.

Point 2

The District Court Properly Conditioned Production on I.R.S. Reimbursement of the Reasonable and Necessary Expenses of Duplication.

The Government contends that the District Court was legally prohibited from conditioning compliance on I.R.S. reimbursement of the reasonable and necessary expenses of duplication. The District Court, faced with a situation where the I.R.S. was seeking redundant materials solely for its own convenience, properly concluded that in the circumstances of this case, the taxpayer should not be required to bear the unusual costs of compliance. The District Court did *not* in any way indicate that the I.R.S. must reimburse the costs of complying with I.R.S. summonses seeking information necessary for completion of the audit and not already in the I.R.S.'s possession. In fact, as the record demonstrates (A-53-54, A-67-70), Continental has for the last decade annually incurred substantial expenses in cooperat-

ing with the continuous team audits of its returns. It has never sought, and does not now seek, reimbursement for these costs, such as the cost of providing an office at its headquarters for the exclusive use of the I.R.S. agents. Furthermore, the Government's position on this point is difficult to understand. The District Court merely required the I.R.S. to follow *the I.R.S.'s own administrative practice of reimbursing taxpayers for any duplication costs they incur in making copies of materials available for the I.R.S.* Internal Revenue Manual ¶ 403(21).

A. The District Court Has the Authority To Condition Enforcement On Reimbursement

As the Government concedes (Gov't Brief, p. 14), it is seeking to have this Court overrule a long line of decisions which have ordered reimbursement in summons enforcement proceedings. *See, e.g., United States* v. *Davey*, 426 F.2d 842 (2d Cir. 1970); *United States* v. *Friedman*, —— F.2d ——, 76-1 U.S.T.C. ¶ 9328 (3d Cir. 1976); *United States* v. *Farmers & Merchants Bank*, 75-2 U.S.T.C. ¶ 9791 (C.D. Calif. 1975), *appeal pending* C.A. No. 75-3690 (9th Cir.); *cf. United States* v. *Dauphin Deposit Trust Company*, 385 F.2d 129 (3d Cir. 1967), *cert. denied*, 390 U.S. 921 (1968); *United States* v. *First National Bank of Fort Smith*, 173 F. Supp. 716 (W.D. Ark. 1959).

These decisions are based on the fundamental proposition that the enforcement of I.R.S. summonses has been committed to the courts in order to safeguard the interests of the various parties involved. *United States* v. *Powell*, 379 U.S. 48 (1964); *Interstate Commerce Commission* v. *Brimson*, 154 U.S. 447, 485 (1894) (summons enforcement cannot be committed to an administrative agency); *cf. Textile Workers Union* v. *Lincoln Mills*, 353 U.S. 448 (1957). The District Courts have broad discretion to impose conditions and restrictions on the Government before order-

ing enforcement of an administrative summons. *In Re Magnus, Mabee & Reynard, Inc.*, 311 F.2d 12 (2d Cir. 1962), *cert. denied*, 373 U.S. 902 (1963); *Walling* v. *American Rolbal Corp.*, 135 F.2d 1003, 1005 (2d Cir. 1943); *Goldberg* v. *Truck Drivers Local Union No. 299*, 293 F.2d 807, 814 (6th Cir. 1961). The ability, in appropriate circumstances, to condition enforcement on the reimbursement of the necessary expenses of compliance is simply a corollary of this long-recognized power. *United States* v. *Friedman, supra.*

The Government argues that a court may never, under any circumstances, require a governmental agency to reimburse a party for its reasonable and necessary expenses of complying with an administrative summons. This argument is grounded in the doctrine of sovereign immunity as set out in *United States* v. *Chemical Foundation, Inc.*, 272 U.S. 1 (1926). The *Chemical Foundation* decision, however, held merely that the United States was not liable for *court costs* in the absence of a statutory provision. Continental is not seeking to recover court costs, but rather is seeking reimbursement for the direct economic costs of making its machinery and personnel available to produce duplicate tapes which will be used solely for the convenience of the I.R.S. *Chemical Foundation* is thus totally inapposite. Moreover, Congress has overruled the *Chemical Foundation* result on the ground that the underlying sovereign immunity rationale is anachronistic and inequitable. *See* 28 U.S.C. § 2412 (a) (1966), *as amended by* Pub. L. 89-507. *See also* Senate Report No. 1329, 89th Cong., 2d Sess. (1966).

The Government appears also to contend that the District Court's power to condition compliance on the reimbursement of reasonable and necessary expenses is somehow negated by the doctrine that "the public . . . has a right to every man's evidence." (Gov't Brief, p. 13). The allocation of the costs required in order to produce documents has nothing to do with the question whether the

documents are to be produced.[8] Presumably, the Government is saying that the reimbursement question is to be resolved by analogy to the procedures used with respect to judicial subpoenas issued in civil and criminal proceedings. Continental agrees, for if it had been subpoenaed to produce the tapes in connection with civil or criminal litigation (including grand jury proceedings) the District Court would have unquestioned authority to require the Government to reimburse Continental for its costs. Rule 45(b) of the Federal Rules of Civil Procedure states:

> "The court . . . may . . . condition denial of the motion [to quash] upon the advancement by the person in whose behalf the subpoena is issued of the reasonable costs of producing the books, papers, documents, or tangible things."

Rule 17(c) of the Federal Rules of Criminal Procedure likewise provides the court with discretion to "quash or modify" any subpoena, and the courts may order the Government to pay the fees and costs of the party subpoenaed. *United States* v. *Bryant*, 311 F. Supp. 726 (D.D.C. 1970). *See also* Advisory Committee Notes which state that Rule 17(c) is intended to adopt the provisions of Rule 45(b) of the Federal Rules of Civil Procedure.

B. The District Court Properly Conditioned Enforcement in This Case on I.R.S. Reimbursement.

Conceding, as it must, that the courts have frequently conditioned the enforcement of I.R.S. summonses on reimbursement of the necessary associated expenses (Gov't. Brief, p. 14), the Government asserts that reimbursement

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[8] The Government's reliance on *Hurtado* v. *United States*, 410 U.S. 578 (1973) is misplaced. In *Hurtado*, a statute provided a specified *per diem* for material witnesses. The Court upheld the statute against a claim that material witnesses are entitled to greater compensation. In the present case, no statute prohibits or limits the District Court's power to order the reimbursement of Continental's costs.

is appropriate only in "rare instances" involving third parties, where the costs are "unreasonable or oppressive." (Gov't Brief, pp. 14-15). No such tests have been developed by the courts. Instead, the propriety of reimbursement depends upon a flexible weighing of all factors present in a given case in order to determine whether the expenses involved are those that the taxpayer "may reasonably be expected to bear as a cost of doing business." *United States* v *Friedman, supra.*

The District Court engaged in precisely that type of weighing in the present case. Extensive testimony was presented on the risks of loss or damage, the costs of producing duplicate tapes, the I.R.S.'s reasons for seeking the tapes, and the substantial unreimbursed costs Continental already incurs in complying with I.R.S. information requests. The District Court, in accordance with the standards provided by other reimbursement cases, clearly concluded that a taxpayer cannot "reasonably be expected . . . as a cost of doing business" to incur the special expenses of duplicating computer tapes to serve the convenience of the I.R.S. agents.

CONCLUSION

For the foregoing reasons, the District Court's Order requiring production of the tapes should be reversed. Alternatively, if the tapes are to be produced, the District Court's Order authorizing the taxpayer to produce duplicate tapes upon I.R.S. reimbursement of the reasonable and necessary costs of duplication should be affirmed.

Respectfully submitted,

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Dated: Washington, D. C.
May 14, 1976

STATUTORY APPENDIX

Statutes Involved

Section 7602 of Internal Revenue Code of 1954, 26 U.S.C. § 7602:

SEC. 7602. EXAMINATION OF BOOKS AND WITNESSES.

For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary or his delegate is authorized—

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

Section 7604(a) of Internal Revenue Code of 1954, 26 U.S.C. § 7604(a):

SEC. 7604. ENFORCEMENT OF SUMMONS.

(a) JURISDICTION OF DISTRICT COURT.—If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, records, or other data, the United States district court for the district in which such person resides or is found shall

have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, records, or other data.

(B) ADMINISTRATIVE DETERMINATION:

Internal Revenue Manual, ¶ 403(21):

403(21) OBTAINING COPIES OF BUSINESS RECORDS.

(1) Generally copies of business records, including print-outs from electronic accounting systems, should be obtained only if actual copies of a document are needed for evidentiary use, or if obtaining copies of documents will result in a material saving of time.

(2) In many instances, needed copies of records are furnished at no expense to the Service. Such offers should be accepted. When it is considered necessary to obtain copies of records which are not offered free of cost, the circumstances in the particular case should govern whether Service-owned equipment should be used. It will generally be in the best interest of the Service to use Service-owned equipment (either portable or office-type) if the records are available for only a limited time.

(3) If an examining officer needs copies of only a few documents, it generally would result in more effective utilization of time to pay for copies of documents, rather than attempt to make arrangements to use Service-owned equipment. Payments may be made with imprest funds as provided for by IRM 1727. An examiner on travel status may claim reimbursement on his travel voucher.

Internal Revenue Manual ¶ 42(13)1.6(8)(b):

* * *

(b) The magnetic tapes or disks may be shipped from place to place through regular mail. The receiver should make written acknowledgement or receipt to the sender, i.e., region to district, district to region, district to district. Magnetic tapes or disks requisitioned from the National Office may be shipped from place to

place through regular mail. The receiver in each instance should make written acknowledgement of receipt to the sender and forward a copy of the acknowledgement to the National Office, Audit Division, CP:A:P. This will provide the National Office with the current location of these tapes and disks.

CERTIFICATION OF SERVICE BY MAIL

I, Teresa L. Webb, an agent of the law printing firm of Byron S. Adams Printing, Inc. of Washington, D.C., being of mature age and familiar with the requirements of service of briefs and other similar legal documents, do hereby certify that on this 14th day of May, 1976, two copies of a document entitled

IN THE
UNITED STATES COURT OF APPEALS
For the Second Circuit

No. 76-6040

United States of America and Walter Ross,
Revenue Agent, Internal Revenue Service,
Petitioners-Appellants,
Cross-Appellees,

v.

Geoffrey Davey, As Secretary of the Continental Corporation,
Respondent, Cross-Appellant

BRIEF OF RESPONDENT-APPELLEE
AND CROSS-APPELLANT

were served on the following person, who has been represented to me as opposing counsel in said action, by first class mail, with proper postage applied and deposited in a mail box of the United States Postal Service:

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